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SPECIALISTS IN SATELLITE, MEDIA AND TELECOM INVESTMENT BANKING

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Media 2007: The year that wasn't, the year that was, and the year that will be

If any year in this decade will be seen as the pivotal time of transition from old to new in the world of media, 2007 may well be the one we will look back upon. At approximately this time last year, we presented a sector overview in this newsletter, in which we took the temperature of three high-profile and in our view landmark transactions for the traditional media industry, wondering how each of these would conclude and, more importantly, the impact of each on its respective sector in 2007 and beyond. It is in ways a reflection of that industry, that with twelve months behind us none of the three referenced deals has closed at the time of this writing – one having fallen apart outright and some uncertainty having continued to mark the others to varying degrees. Concurrently, operating results for traditional media operators – newsprint and radio in particular – have disappointed, and in many cases even deteriorated. This general lack of progress may lead observers like us to see 2007 as a year that was skipped over, as it were, by traditional media… particularly if contrasted with its counterpart, new media, wherein we have watched a series of transactions and strategic alliances taking center stage and causing our collective heads to spin. The themes of industry transition and consumer trends that underlie these and similar events shed light, no doubt, about 2008 on the horizon. Let's have a closer look:

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Traditional media, the year that wasn't

…general lack of progress in traditional media leads us to see 2007 as a year that was skipped over, particularly in contrast to new media developments taking center stage and causing our collective heads to spin...

- Of the three indicative traditional media transactions, the **Cablevision Systems** going-private deal, which was in the throes of various proposals at this time last year, was finally approved by the company's board only to be rejected by shareholders subsequently. With that, the company's stock price commenced a downward slide (from a 52-week high of $39.75 to its recent price of roughly $24) to join the rest of its peer group, which had been heading in that direction for some time already.

- The two deals that are still hanging in, expected to close but still the subject of new rumors, speculations, and turns of financial tides, are the **Tribune Co.** and **Clear Channel** buyouts. While we await the conclusions of these situations (with Tribune especially considered now close to done), we continue to observe revenue growth challenges (to say the least) in both radio and newsprint, as advertisers continue to source new outlets for their campaigns. Credit market turmoil, to be sure, has not helped these situations; but healthy growth platforms, let's be honest, need not rely on high financial leverage to generate equity returns.

… which brings us, in contrast, to…

New media and the year that was

Reflecting a shifting media terrain whereby rapidly growing and highly popular platforms, usually Internet based, are attracting both financial and strategic investor attention, we note the following sampling of key transactions in chronological order:

…while the transactions cited are a cross-section and not a comprehensive listing, these are exemplary of larger patterns and trends likely to continue…

- **Google/YouTube**. Although technically a November 2006 event, this deal raised eyebrows and stirred up ripples that immediately crossed into the new year and continued well into 2007, not only by its roughly $1.6 billion magnitude (for a company with $13 million in annual revenue at the time of the transaction), but more importantly as a landmark announcing the mass market arrival of Internet video. The household broadcasting names soon enough followed suit, and we are now able to watch many of our favorite prime time episodes on the web, at our leisure, free of charge.

- **CBS/Last.fm**. On the Internet radio front, while much of the sector was fighting to stand its ground against a royalty hike by the copyright board, which was and may still be threatening the demise of the larger platforms through a vastly uneconomic royalty model, the globally popular though relatively upstart music/social networking site referenced was on May 30 acquired by the diversified media giant for $260 million. Like YouTube previously and Facebook (see below), this transaction demonstrated the value of a large and defensible Internet presence, even if the revenue model has not yet caught up. Due to its emphasis on social networking, Last.fm may have been less exposed than others to royalty rate discussions, and along the same lines we parenthetically also note the emergence of a new Internet radio operator, **Slacker**, which was able to circumvent copyright board requirements altogether, having negotiated individual deals with music labels. With such reference points in addition to progress being made, albeit slowly, in ongoing royalty discussions by the industry, we clearly see lots of life in Internet radio yet.

- **CBS/SignStorey**. The supermarket-focused digital signage company was acquired on October 5 for a reported $71.5 million to serve as the platform for what has become **CBS Outernet**, the media company's aggressive expansion in the digital signage arena. Combining CBS content and advertising muscle, this deal could be a breakthrough for a sector that has for several years now worked diligently and with mixed success to garner strength. Although the advertising community has been slow in showing support for digital signage technology, we continue to hear about growing allocations to this outlet in advertising budgets, and, as noted, the aggressive entry of CBS can only be positive for the sector.

- **Microsoft/Facebook**. Having repositioned itself as the social network of choice for the younger set and opened up its platform to software developers, this rapidly growing and enormously popular web destination announced on October 24 that it would accept a $260 million investment from the software titan, presumably as the superior offer to **Google**'s competing overture. Although a minority investment of 1.6%, the resulting enterprise valuation of $15 billion would certainly be difficult to compete with. In parallel with this investment, Microsoft has entered into an advertising deal with Facebook which many analysts believe to be the real motive behind the investment transaction and an artificial driver behind the startling valuation. Nonetheless, a $260 million cash infusion for a company with annual revenues of less than half of that amount by some reports, would be a success even at, say, less than half of the valuation obtained.

The year that will be

While both the traditional and new media transactions cited are merely a cross-section of their respective realms and certainly not a comprehensive listing, we view these cross-sections as exemplary of larger patterns and trends likely to continue into the foreseeable future. The key takeaways:

- As observed in "the year that wasn't" – declining newspaper revenues, flat and sometimes even declining radio revenues, and the pace of deals in these sectors that at least in part reflect this financial performance – there is a redirection of advertising dollars from traditional to new media that may rapidly pick up steam.

… Critical mass in new media is extremely valuable, even as revenues may still be lagging…

- Critical mass in new media is extremely valuable, even as revenues may still be lagging. We see this clearly in "the year that was." The expectation is that revenues will arrive, and that those platforms with massive audience will be in the best position to attract advertising dollars.

- In regard to new media, however, advertisers are likely to measure audience size differently from that of traditional media outlets. For example, an Internet radio destination with more than even a million listeners, may as a result of its content and geographical diversity, actually present a target audience of far less than a million to any particular advertiser. We offer this in contrast to, say, a similar aggregate audience-size radio property, with a particular format and geographical concentration. The same issues of critical mass and audience dilution is seen in digital signage, a sector which is still far from having achieved ubiquitous market coverage, and for which the key selling challenge has been its ability to demonstrate compelling audience size to advertisers.

… there has also been a correlation between audience quality and enterprise value…

- With the above illustration as a backdrop, we note the vast valuation differentials between Last.fm (15 million users to-date, geographically and demographically fragmented audience, $260 million), Facebook (50 million active users with well defined demographic focus, $15 billion), and SignStorey (roughly 1,500 store locations with passive audience and short attention cycles, $72 million). We believe this data to highlight the correlation between critical mass, but also audience type, to enterprise value.

- For advertising-based new media models, the focus should therefore be not only on audience quantity but also quality. While a narrow focus (in terms of geography, location, or content) may allow such platforms to demonstrate a well defined target demographic, this is unlikely to maximize audience size. Moreover, local/regional or other limited-scope advertising sales are a less efficient (i.e. more expensive to produce) revenue source than national advertising can be. The key for many new media companies will be to strike the right balance.

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- Interestingly, the companies best positioned to succeed in new media may be traditional media companies. These have the most developed sales forces, established audiences and brand cache, and the ability to finance new media projects with (still) cash flow from existing operations at a (still) attractive cost of capital. The challenge for many traditional media operators has been to make the necessary transition, culturally and otherwise. It remains to be seen if market forces and necessity will expedite that process in 2008.

- Regardless of whether the traditional media companies mentioned in this article will complete their deals in 2008, we would expect these and many other operators in their peer groups to show a continuing emphasis on new media initiatives, consistent with the points raised herein. We would also not be surprised to see continuing consolidation in the sector, not only along geography but also product lines, pursuant to the FCC's cross-ownership vision as manifest in rules recently set in place, and further exemplified by the agreed-to acquisition of **Dow Jones** by **NewsCorp**.

We look forward to revisiting this article twelve months from now and reporting on our findings. In the meantime, here's to a Happy New Year and productive times ahead for everyone!

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